

SAN FRANCISCO PUBLIC LIBRARY



3 1223 08514 2876

5/S



San Francisco Public Library

Government Information Center
San Francisco Public Library
100 Larkin Street, 5th Floor
San Francisco, CA 94102

REFERENCE BOOK

Not to be taken from the Library

D
REF
388.4132
Sa578ch
2008

City and County of San Francisco

Office of the Controller – City Services Auditor

AIRPORT COMMISSION:

Concession Audit of The Hertz Corporation

DOCUMENTS DEPT.

JUN 17 2008

SAN FRANCISCO
PUBLIC LIBRARY



June 13, 2008

**CONTROLLER'S OFFICE
CITY SERVICES AUDITOR**

The City Services Auditor was created within the Controller's Office through an amendment to the City Charter that was approved by voters in November 2003. Under Appendix F to the City Charter, the City Services Auditor has broad authority for:

- Reporting on the level and effectiveness of San Francisco's public services and benchmarking the city to other public agencies and jurisdictions.
- Conducting financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operating a whistleblower hotline and website and investigating reports of waste, fraud, and abuse of city resources.
- Ensuring the financial integrity and improving the overall performance and efficiency of city government.

The audits unit conducts financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

We conduct our audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office (GAO). These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

Audit Team: Elisa Sullivan, Audit Manager
Helen Vo, Associate Auditor



CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

June 13, 2008

San Francisco Airport Commission
P.O. Box 8097
San Francisco, CA 94128

President and Members:

The Controller's Office, City Services Auditor, presents its report concerning the audit of The Hertz Corporation (Hertz). Hertz has a 10-year agreement, through December 29, 2008, with the Airport Commission of the City and County of San Francisco (City) to operate a car rental service at the car rental facility on Airport property.

Reporting Period: December 30, 2002, through December 29, 2005

Fees Paid: \$22,750,036

Results:

Although Hertz reported gross revenues of \$227,500,357 and paid fees of \$22,750,036 to the Airport Department (Airport), Hertz failed to report \$5,306,217 of revenues for local rentals, employee business rentals, and satellite radio rentals. In addition, Hertz improperly deducted commercial discounts and unsupported revenue adjustments of \$3,676,509 from its reported revenues.

As a result of Hertz' underreporting of revenues, Hertz owes fees of \$898,274. Hertz also owes the Airport \$494,255 in interest charges as of December 31, 2007, and because it significantly underpaid its fees, it owes approximately \$87,300 for the cost of this audit.

The responses from the Airport and from Hertz are attached to this report. The Controller's Office, City Services Auditor disagrees with two of the Airport's responses, and we have attached a rebuttal explaining our position on these issues. Further, under the terms of the agreements between the City, the Airport, and the airlines using the Airport, there is a \$134,741 general fund impact for all findings; the impact for disputed findings is approximately \$122,095.

We will be working with the Airport to follow up on the status of the recommendations made in this report.

Respectfully submitted,

Robert Tarsia
Deputy Audit Director

cc: Mayor
Board of Supervisors
Civil Grand Jury
Public Library

Page intentionally left blank.

INTRODUCTION

Audit Authority

The Office of the Controller (Controller) has authority under the San Francisco Administrative Code, Chapter 10, Article 1, Section 10.6-2 to audit, at regular intervals, all leases of City-owned real property where rent of \$100,000 or more a year is to be paid to the City.

Background

The Hertz Corporation (Hertz) has a 10-year agreement with the San Francisco Airport Commission (Commission) of the City and County of San Francisco (City) to operate a car rental service at the rental car facility at the San Francisco International Airport. The agreement, which is on a contract year from December 30th through December 29th, will expire on December 29, 2008. The agreement requires Hertz to pay the Airport Department (Airport) the greater of a minimum annual guarantee (MAG) or ten percent of its gross revenues. The MAG was \$676,908 from the start of the agreement through December 29, 2003, and was modified to \$609,218 for the period thereafter.

Scope

The purpose of this audit was to determine if Hertz complied with the reporting and payment provisions of its agreement with the Commission. Our audit covered the period December 30, 2002, through December 29, 2005.

Methodology

To conduct the audit, we examined the applicable terms of the agreement and the adequacy of Hertz' procedures for collecting, recording, summarizing, and reporting its gross revenues to the Airport. To determine whether Hertz accurately reported its gross revenues to the Airport, we tested on a sample basis Hertz' monthly revenue summaries, daily rental reports, and rental agreements. We also compared the gross revenues reported to the Airport with the gross revenues reported to the California Board of Equalization for selected calendar quarters.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

Hertz Owes Additional Fees of \$898,274 to the Airport

From December 30, 2002, through December 29, 2005, Hertz reported gross revenues of \$227,500,357 and paid concession fees of \$22,750,036 to the Airport. Exhibit 1 shows the reported gross revenues and concession fees paid to the Airport.

EXHIBIT 1 Gross Revenues and Fees Paid December 30, 2002, Through December 29, 2005

Reporting Period	Gross Revenues	Concession Fees Paid
December 30, 2002, through December 29, 2003	69,299,814	6,929,981
December 30, 2003, through December 29, 2004	75,220,435	7,522,044
December 30, 2004, through December 29, 2005	82,980,108	8,298,011
Total	\$227,500,357	\$22,750,036

Sources: Hertz's Audited Statements of Gross Receipts and Concession Payments.

However, Hertz failed to report \$5,183,701 of revenues for local rentals, \$51,061 in employee business rentals, and \$71,455 in satellite radio rentals. In addition, Hertz improperly deducted \$2,955,934 in commercial discounts and \$720,575 in unsupported revenue adjustments. Further, the Airport may have applied an erroneous over-credit of \$270,764 to Hertz' account. As a result of Hertz' underreporting of revenues, Hertz owes additional fees of \$898,274, as detailed in Exhibit 2. Further, because Hertz did not pay these fees when due, it also owes the Airport \$494,255 in interest calculated through December 2007. Moreover, because the underpayment was more than two percent of its annual rent, the lease requires Hertz to reimburse the Airport for the cost of this audit, which is approximately \$87,300.

EXHIBIT 2 Additional Fees Owed for December 30, 2002, Through December 29, 2005

Revenue Category	2003	2004	2005	Total
Local Rental Fees	\$ 195,583	\$ 156,904	\$ 165,884	\$ 518,371
Employee Business Rentals	1,550	2,038	1,518	5,106
Satellite Radio	2,332	2,044	2,769	7,145
Commercial Discounts	110,700	123,331	61,563	295,594
Improper Adjustments	20,733	24,729	26,596	72,058
Total	\$ 330,898	\$ 309,046	\$ 258,330	\$ 898,274

Sources: Hertz's Monthly Statements & Airport's credit documents, Concessionable Revenue Analysis Reports and Satellite Radio Reports.

Hertz owes \$518,371 in local rental fees

Hertz failed to report revenues of \$5,183,701 for local rentals and owes \$518,371 in fees to the Airport. Our prior concession audit of Hertz, issued March 3, 2000, disclosed the same finding and Hertz agreed to pay the fees owed on local rental revenues during that audit period. However, at that time, Hertz' director of properties stated that Hertz had a different interpretation of the agreement.

According to the agreement, Hertz is to pay fees on gross revenues which are defined as the "gross amount received by Operator, without deduction or offset, from all vehicles rented at the Airport." However, the agreement further defines vehicles rented at the Airport. One of the additional definitions of a vehicle rented at the Airport is that the rental car customer is an air passenger who rents a vehicle within 24 hours of arrival at the Airport. At the time of our prior audit in 2000, Hertz interpreted this provision to mean that if a customer is not an airline passenger or the customer is an airline passenger who waited more than 24 hours to rent a car, then those rentals are not gross revenues subject to concession fees.

Hertz owes \$5,106 in fees for improperly deducting employee business rentals

Hertz deducted \$51,061 in employee business rentals from gross revenues reported to the Airport and owes \$5,106 in fees. An employee business rental occurs when a Hertz employee traveling on Hertz business rents and pays for the car rental out-of-pocket and submits an employee expense report for reimbursement from Hertz. Hertz then deducts these rentals from revenues reported to the Airport. Because the agreement states that Hertz is to report all gross amounts received, without deduction or offset, from all vehicles rented at the Airport, we did not allow this deduction. The agreement does state that certain charges are not includable in gross revenues, but employee business rentals are not specifically listed in the agreement.

Hertz owes \$7,145 in fees for unreported satellite radio revenue

Hertz failed to report \$71,455 in satellite radio rental revenues and owes \$7,145 in fees for our audit period. According to Hertz' audit administrator, Hertz first offered the satellite radio option in November 2002, but did not collect revenues until March 2003. Hertz has not included these revenues when reporting its gross revenues to the Airport; however, it does agree that satellite radio should be included as revenue subject to fees.

Hertz owes \$295,594 in fees for improperly deducting commercial discounts from gross revenues

Hertz improperly deducted \$2,955,934 in commercial discounts and owes \$295,594 in fees to the Airport. Hertz has numerous agreements with corporations in which Hertz pays dividends to these corporations once the corporation has reached a certain preset rental volume. Hertz then deducts the dividends, or commercial discounts, from gross revenues. The agreement states that Hertz is to report all gross amounts received, without deduction or offset, from all vehicles rented at the Airport. The agreement does state that certain charges are not includable in gross revenues, but dividends or commercial discounts are not specifically listed in the agreement.

Hertz owes \$72,058 in fees for improper adjustments to gross revenues

Hertz improperly deducted revenue adjustments of \$639,518, and "Source 31" adjustments of \$81,057, totaling \$720,575 in adjustments, and therefore owes \$72,058. Revenue adjustments are adjustments made to revenue after the customer has rented the vehicle, usually because the customer is disputing a charge. Source 31 adjustments are adjustments made to revenue at the rental counter. While these deductions may be valid, we were unable to verify the existence and accuracy of a sample of these adjustments, because according to Hertz' audit administrator, there are no supporting documents for either of these types of adjustments. Nevertheless, according to the agreement, Hertz is to report all gross amounts received, without deduction or offset, from all vehicles rented at the Airport. As noted above, the agreement states that certain charges are not includable in gross revenues, but adjustments are not specifically listed in the agreement.

The Airport may have applied an erroneous over-credit of \$270,764

Effective December 30, 2003, the minimum annual guarantee (MAG) was reduced from \$676,908 to \$609,218. However, Hertz continued to pay the higher MAG for January and February 2004, and correctly paid the lower MAG in March 2004 and thereafter. Airport accounting staff did not become aware of the change in MAG until June 2004, at which time Airport accounting staff issued a credit memo of \$406,145 for the six-month period from January through June 2004, and therefore over-credited Hertz for four months.

The Airport's chief accountant maintains that it did not over-credit Hertz because Hertz did not take the credit and Hertz staff confirmed that it, in fact, did not take the credit.

However, we noted that Airport accounting personnel did apply the credit to Hertz' account, yet Hertz' account does not show an outstanding credit of \$270,764, as would be expected if Hertz had paid its full monthly fees and not taken the credit. Alternately, the Airport could have reversed the credit in Hertz' account, but we did not note a credit reversal in the Airport's accounting records.

Hertz Owes \$494,255 in Interest on Unpaid Fees and \$87,300 for Audit Costs

Because Hertz did not pay all its fees when due, Hertz owes \$494,255 in interest. According to the agreement, fees not paid when due are subject to interest at the rate of one and one-half percent per month, or \$494,255 as of December 31, 2007. We identified the net amount of fees that Hertz had not paid each year during our audit, and calculated the interest that Hertz owes the Airport through December 2007.

Hertz must also pay the Airport for the cost of this audit, which is approximately \$87,300 as of December 31, 2007. Hertz' agreement states that if an underpayment exceeds two percent of the total annual fees due, Hertz will reimburse the City for all costs incurred in the conduct of this audit.

The Airport Did Not Enforce Compliance of Required Annual Reports of Gross Revenues From Hertz

We could not determine whether Hertz was in compliance with a provision of the agreement which states that Hertz is to submit to the Airport a certified report of annual gross revenues within 90 days of each anniversary of the commencement date. The dates tracked by Airport accounting staff do not reflect the actual dates that the Airport's property manager received the annual reports.

In addition, the annual reports of gross revenues for 2003 and 2004 on file at the Airport were not signed by a certified public accountant. According to the agreement, the annual gross revenues reports must be certified by a certified public accountant. We obtained signed copies from Hertz and informed the Airport's property management and accounting sections that annual reports received should be certified by a certified public accountant.

Recommendations

The Airport Department should collect from Hertz the following fees owed:

1. Local rental fees of \$518,371.

2. Employee business rental fees of \$5,106.
3. Satellite radio rental fees of \$7,145.
4. Commercial discount fees of \$295,594.
5. Revenue adjustment fees of \$72,058.

The Airport Department should also:

6. Review Hertz' account to determine how the application of the \$270,764 credit failed to result in an outstanding credit balance if Hertz paid the full monthly fee for the months in question.
7. Collect from Hertz interest of \$494,255 and audit costs of \$87,300.
8. Document the dates that it receives the annual reports of gross revenues and ensure the annual reports are certified by a certified public accountant as required by the lease.
9. Work with Hertz to determine the fees owed from local rental revenue, employee business rental revenue, satellite radio revenue, commercial discount deductions, and adjustment deductions for the periods before and after our audit period.
10. Require Hertz to include in gross revenues local rentals and satellite radio, and to discontinue deducting employee business rentals, commercial discounts and adjustments from gross revenues.
11. Include in its new agreement with Hertz a comprehensive definition of gross revenues and exclusions to gross revenues that both parties agree to and understand.

ATTACHMENT: AIRPORT'S RESPONSE



San Francisco International Airport

June 3, 2008

P.O. Box 8097
San Francisco, CA 94128
Tel: 415 871 5000
Fax: 415 871 5005
www.flysfo.com

Mr. Robert Tarsia
Deputy Audit Director
City Hall
1 Dr. Carlton B. Goodlett Plaza
San Francisco, CA 94102

Subject: San Francisco International Airport's response to Controller's Audit of
Hertz Corporation Lease No. 97-0052

AIRPORT
COMMISSION
CITY AND COUNTY
OF SAN FRANCISCO

GAVIN NEWSOM
MAYOR

LARRY MAZZOLA
PRESIDENT

LINDA S. CRAYTON
VICE PRESIDENT

CAROL ITO

ELEANOR JOHNS

RICHARD J. GUGGENHEIM

JOHN I. MARTIN
AIRPORT DIRECTOR

Dear Mr. Tarsia:

The San Francisco International Airport ("Airport") is in receipt of the audit ("Audit Report") performed by the Office of the Controller for the City and County of San Francisco ("Controller") of the Hertz Corporation Lease No. 97-0052 ("Lease"). The following is the Airport's response to the Audit Report findings:

- 1. Hertz Owes \$518,371 in Local Rental Fees:** The Airport disputes this finding. Under the Lease, Hertz must pay "Gross Revenue" for "all vehicles rented at the Airport". See Lease Article 3.01.a. Further, the Lease defines vehicles rented at the Airport if "the rental car customer is an air passenger who rents a vehicle within 24 hours of arrival at the Airport". See Lease Article 30.1.a.iii. Taken together, the Airport interprets this language to require Hertz to only calculate gross revenue for those vehicles rented by air passengers arriving at the Airport within twenty-four hours. Thus, Hertz is not required to calculate gross revenue for certain "Local Rentals," those customers who are not air passengers arriving within the last 24 hours. Provided Hertz adequately documents these "Local Rentals," the Airport considers said rentals are not included in the calculation of gross revenue.
- 2. Hertz Owes \$5,106 in Fees for Improperly Deducting Employee Business Rentals:** The Airport accepts this finding.
- 3. Hertz Owes \$7,145 in Fees for Unreported Satellite Radio Revenue:** The Airport accepts this finding.
- 4. Hertz Owes \$295,594 in Fees for Improperly Deducting "Commercial Discounts" From Gross Revenues:** The Airport disputes this finding. The Airport has consulted with our legal counsel, the City Attorney's Office, and believes the language stated in Lease Article 3.01.a., "without deduction or offset" does not include any commercial or promotional discounts offered by Hertz to third parties, e.g. Hertz corporate clients. While the language may cause confusion, the Airport maintains that Hertz must pay Gross Revenues based on the amount received,

regardless of whether or not it was discounted at time of rental or at a later date. The Airport considers corporate volume discounts to be allowable under the existing lease language.

5. **Hertz Owes \$72,058 in Fees for Improper Adjustments to Gross Revenues:** The Airport accepts this finding if Hertz is unable to justify the adjustments to gross revenues.
6. **The Airport Over-credited Hertz by \$270,764 in Fees:** The Airport will conduct a detailed review of Hertz's payment history to include the issuance and application of credits. If an over-credit is found, it will be reversed.
7. **Hertz Owes \$494,255 in Interest on Unpaid Fees and \$87,300 for Audit Costs:** Based on the Airport's comments noted above, it is likely the interest owed by Hertz will change. If the Controller accepts the Airport's response contained in this letter, the interest fees will need to be recalculated. Additionally, it appears the cost of the audit may be waived due to the findings being less than 2% of the total annual fee due during the audit period.
8. **Airport Did Not Enforce Compliance of Required Annual Reports of Gross Revenues From Hertz:** Going forward, the Airport will ensure that all annual statements are collected as required under the Lease and submitted in an acceptable format.
9. The Airport will request that Hertz certify its deductions from Gross Revenues for employee business rentals and satellite radio rentals and submit the appropriate concession rent to the Airport for the periods before and after the Audit reporting period. The periods the Airport will follow up on are December 30, 1998 through December 29, 2002 and again from December 30, 2005 through the present. Additionally, the Airport will require Hertz to include these items in Gross Revenues from now until the end of its present lease. The new lease will have an all-inclusive Gross Revenues definition.
10. The Airport will notify Hertz those employee business rentals for which a sales record is generated and satellite radio rentals must be included in Gross Revenues as stated on their monthly and annual certified statements.
11. As stated previously, the Airport will create a tickler file and ensure that all annual certified statements are submitted in a timely manner and in the correct format.
12. The Airport is currently writing the new rental car concession lease and will include an all-inclusive gross revenues definition. It will include a few very clearly stated deductions. Any transaction that is not specifically allowed as a deduction will be considered Gross Revenues and, therefore, concessionable.

Mr. Robert Tarsia
June 3, 2008
Page 3

We thank you for your staff's work on this audit. Please do not hesitate to call if you have any questions.

Sincerely,



Cheryl Nashir
Associate Deputy Airport Director
Revenue Development and Management

cc: Elisa Sullivan
Leo Fermin
Cesar Sanchez
Gigi Ricasa
Matthew McCormick

Recommendation	Responsible Agency	Response
1. The Airport Department should collect from Hertz the following fees owed: local rental fees of \$518,371.	Airport	The Airport disputes this finding. Under the Lease, Hertz must pay "Gross Revenue" for "all vehicles rented at the Airport". See Lease Article 3.01.a. Further, the Lease defines vehicles rented at the Airport if "the rental car customer is an air passenger who rents a vehicle within 24 hours of arrival at the Airport". See Lease Article 30.1.a.iii. Taken together, the Airport interprets this language to require Hertz to only calculate gross revenue for those vehicles rented by air passengers arriving at the Airport within twenty-four hours. Thus, Hertz is not required to calculate gross revenue for certain "Local Rentals," those customers who are not air passengers arriving within the last 24 hours. Provided Hertz adequately documents these "Local Rentals," the Airport considers said rentals are not included in the calculation of gross revenue.
2. The Airport Department should collect from Hertz the following fees owed: employee business rental fees of \$5,106.	Airport	The Airport accepts this finding.
3. The Airport Department should collect from Hertz the following fees owed: satellite radio rental fees of \$7,145.	Airport	The Airport accepts this finding.
4. The Airport Department should collect from Hertz the following fees owed: commercial discount fees of \$295,594.	Airport	The Airport disputes this finding. The Airport has consulted with our legal counsel, the City Attorney's Office, and believes the language stated in Lease Article 3.01.a., "without deduction or offset" does not include any commercial or promotional discounts offered by Hertz to third parties, e.g. Hertz corporate clients. While the language may cause confusion, the Airport maintains that Hertz must pay Gross Revenues based on the amount received, regardless of whether or not it was discounted at time of rental or at a later date. The Airport considers corporate volume discounts to be allowable under the existing lease language.
5. The Airport Department should collect from Hertz the following fees owed: revenue adjustment fees of \$72,058.	Airport	The Airport accepts this finding if Hertz is unable to justify the adjustments to gross revenues.

Recommendation	Responsible Agency	Response
6. The Airport Department should also: review Hertz' account to determine how the application of the \$270,764 credit failed to result in an outstanding credit balance if Hertz paid the full monthly fee for the months in question.	Airport	The Airport will conduct a detailed review of Hertz's payment history to include the issuance and application of credits. If an over-credit is found, it will be reversed.
7. The Airport Department should also: collect from Hertz interest of \$494,255 and audit costs of \$87,300.	Airport	Based on the Airport's comments noted above, it is likely the interest owed by Hertz will change. If the Controller accepts the Airport's response contained in this letter, the interest fees will need to be recalculated. Additionally, it appears the cost of the audit may be waived due to the findings being less than 2% of the total annual fee due during the audit period.
8. The Airport Department should also: document the dates that it receives the annual reports of gross revenues and ensure the annual reports are certified by a certified public accountant as required by the lease.	Airport	Going forward, the Airport will ensure that all annual statements are collected as required under the Lease and submitted in an acceptable format. As stated previously, the Airport will create a tickler file and ensure that all annual certified statements are submitted in a timely manner and in the correct format.
9. The Airport Department should also: work with Hertz to determine the fees owed from local rental revenue, employee business rental revenue, satellite radio revenue, commercial discount deductions, and adjustment deductions for the periods before and after our audit period.	Airport	The Airport will request that Hertz certify its deductions from Gross Revenues for employee business rentals and satellite radio rentals and submit the appropriate concession rent to the Airport for the periods before and after the Audit reporting period. The periods the Airport will follow up on are December 30, 1998 through December 29, 2002 and again from December 30, 2005 through the present. Additionally, the Airport will require Hertz to include these items in Gross Revenues from now until the end of its present lease. The new lease will have an all-inclusive Gross Revenues definition.

Recommendation	Responsible Agency	Response
10. The Airport should also: require Hertz to include in gross revenues local rentals and satellite radio, and to discontinue deducting employee business rentals, commercial discounts, and adjustments from gross revenues.	Airport	The Airport will notify Hertz those employee business rentals for which a sales record is generated and satellite radio rentals must be included in Gross Revenues as stated on their monthly and annual certified statements.
11. The Airport Department should also: include in its new agreement with Hertz a comprehensive definition of gross revenues and exclusions to gross revenues that both parties agree to and understand.	Airport	The Airport is currently writing the new rental car concession lease and will include an all-inclusive gross revenues definition. It will include a few very clearly stated deductions. Any transaction that is not specifically allowed as a deduction will be considered Gross Revenues and, therefore, concessionable.

ATTACHMENT: HERTZ' RESPONSE

Conita G. Gurich
Director, Revenue

The Hertz Corporation
6111 Century Blvd., Suite 600, Los Angeles, CA 90048
Telephone: (310) 568-3453
Fax: (310) 568-1154

SENT VIA E-MAIL

May 30, 2008

City of San Francisco

Office of the Controller

Attn: Robert Tarsia, Deputy Audit Director,

City Hall, 1 Dr. Carlton B. Goodlett Place

Room 316

San Francisco, CA 94102-4694

Attention: Elisa Sullivan, Audit Manager

Re: Hertz Audit Findings

December 30, 2002 through December 29, 2005

Dear Mr. Tarsia:

Pursuant to the many e-mails between us and Elisa Sullivan, Audit Manager, on above audit findings, we recap our position:

Local rentals were excluded from concessionable revenue because the Concession Agreement identifies a customer as one who rents within 24 hours of arriving at the Airport. Those customers who rent after 24 hours are considered local and excluded from concession fee payments. As we said, we already pay rent on the ground and buildings for the privilege of renting to those customers that are local – those who rent after 24 hours of arriving at the Airport.

As we said in our e-mails to you, it is common business practice to negotiate the items of revenue to be included/excluded from the definition of Gross Revenue. If the percentage fee is increased, then we look to limit the items of revenue to be included in the definition and hence we defined a customer as someone who rents within 24 hours of arriving at the Airport. If the customer rents after 24 hours, then he is considered a local renter and excluded from concession revenue. The parties negotiating the Agreement at the time understood and agreed to the exclusion, otherwise why include the definition of a customer as one who rents within 24 hours of arriving at the Airport.

The Corporate Discount Program is a pricing program that provides the Corporate Customer with a discount on the final rate he pays Hertz depending on the volume of business he does with Hertz. The program is typical of most volume business discounts provided by all manner of companies to sell their product or service so that "the more you buy, the lower your price." A discount program may be provided at the front end of the rental transaction or at the back end depending on the volume of business.

However, we have found, as has the rest of the Industry, that the only way to induce a Corporate Customer to continue renting from us on a volume basis is to provide the discount when he has met a threshold number of rentals before his rate is discounted. If we provided a front end discount, then there would be no incentive for the Corporate Customer to continue renting from Hertz, he would simply shop the market every time he came in to rent a car. As we said to you by e-mail, the major rental cars all vie for the Corporate Accounts through a program similar to ours that provides discounted rates only after meeting a threshold number of rentals. This program has been around for many years and has been a boon to both Airports and rental cars. It has created volume business for all of us.

As I said, the corporate contracts are negotiated for 2 or 3 year terms and the rental companies bid aggressively to get the business. These contracts are won or lost depending on the discounts provided on the rate for services offered by each company. Hertz has been very successful in winning a large segment of the corporate business even though its rental rates are high, even with the discounts provided, because of our level of service. However, we have lost contracts at times when competitors such as National drop their rates so substantially as compared to Hertz that we cannot compete.

As a final note, discounts on the rate by definition are reductions in the total revenue we receive for our service. **Our Concession Agreement requires that we pay on Gross Revenue received, not on a guaranteed price for our service.** Thus the discount we provide the Corporate Customer reduces the revenue on which we pay percentage fees.

As to employee business rentals, these are zero sum gains in revenue to Hertz since we reimburse employees for those rentals. We show the daily rate on the employee business rental agreement as a matter of policy to show the value of the use of that vehicle but it does not result in more revenue to Hertz. We could just as easily have crossed out any price and stated NON REV on the rental agreement and the effect would be the same, no additional revenue to Hertz. It would be unfair for the Airport to collect concession fees on those employee business rentals because they are merely "journal entry" use of our vehicles, they do not produce revenue to Hertz.

Concerning adjustments taken at the counter for errors, we cannot be asked to pay for errors in billing. We do not guarantee payment of fees on erroneous transactions that do not produce revenue to Hertz. If, for example, we erroneously charge a customer for a 3 day rental when the rental was actually 2 days, we adjust the bill at the time the customer pays by deducting the one day charge. Surely, we have a right to correct the bill just as we have an obligation to pay correctly. If the auditor feels that there is a better way to correct errors at the time of closing out the rental contract, please provide your suggestion.

Thank you for your attention to this matter.

Sincerely yours,
Conne G. Gurich

REBUTTAL TO AIRPORT'S RESPONSE

To provide clarity and perspective, the Controller's Office, City Services Auditor Division, is commenting on the response to our audit report from the Airport. The following numbered responses correspond to the numbered responses from the Airport's response.

1. We disagree with the Airport's response. Hertz' lease does not specifically exclude local rental revenues from gross revenues. The Airport correctly states that Hertz must pay fees on their gross revenue for all vehicles "rented at the Airport", and that one of the definitions of "rented at the Airport" is that the rental car customer is an air passenger who rents a vehicle within 24 hours of arrival at the Airport. However, there are four other definitions of "rented at the Airport", and the most reasonable interpretation of the lease language is that a rental is part of gross revenues if any one of the definitions is true. The Airport failed to mention the first definition of "rented at the Airport" in the Hertz lease, Article 3.01.a.i, which is, "if the vehicle is delivered to the customer at Airport". This would appear to include most rentals, regardless of whether the customer is an air passenger or not.

Further, our previous audit of the same lease with Hertz, dated March 3, 2000, included the same finding for local rental fees. The Airport agreed with the finding at that time.

If the Airport wishes to maintain its position that local rental revenues are excluded from gross revenues, then it should amend Hertz' lease to specifically exclude these amounts from gross revenues.

4. We disagree with the Airport's response. Hertz' lease does not specifically exclude commercial discounts from gross revenues. In fact, the lease states that "*gross revenues means the gross amount received by the operator, **without deduction or offset** (emphasis added), from all vehicles rented at the Airport...*" Hertz maintains that commercial discounts are volume business discounts given to corporate clients after the corporate client has reached a preset renting volume. However, Hertz' audit administrator described commercial discounts to us as "dividends" to their corporate clients and Hertz' corporate agreements describe these discounts as "promotional fees" and "performance bonuses". Either some or all of this discount appears to be promotional expenses for Hertz based on agreements they signed with corporate clients, and we believe they should not be deducted from gross revenues at the Airport. Other airports indicated to us that they also do not allow these commercial discounts to be deducted from gross revenues.

Further, these commercial discounts pertain to corporate client rentals accumulated at all Hertz locations, not just at the Airport. Including Hertz' corporate-wide incentive programs would make effective auditing of concessionable revenue difficult and, most likely, not cost effective.

Again, if the Airport wishes to maintain its position that commercial discounts are excluded from gross revenues, then it should amend Hertz' lease to specifically exclude these amounts from gross revenues.

